Franchise Tax Board

ANALYSIS OF AMENDED BILL

Author: Cedillo | Analyst: Roger Lackey | Bill Number: AB 1901

Related Bills: AB 601 (99/00) | Telephone: 845-3627 | Amended Date: 03-23-2000

Attorney: Patrick Kusiak | Sponsor:

SUBJECT: Urban Adaptive Reuse Zones/Qualified Adaptive Reuse Buildings Credit/FTB Report To Legislature Annually Regarding Credit

SUMMARY OF BILL

Under the Government Code, this bill would authorize a new type of economic development area called Urban Adaptive Reuse Zones (UARZ). The Trade and Commerce Agency (TCA) would be authorized to designate up to 10 UARZs from applications submitted by local governing bodies.

Under the Personal Income Tax Law (PITL) and the Bank and Corporation Tax Law (B&CTL), this bill, by conforming with modifications to the federal rehabilitation credit, would allow a state credit equal to either of the following:

1. 20% of the amount paid or incurred during the taxable or income year in connection with the rehabilitation of a qualified adaptive reuse building, or

2. 30% of the amount paid or incurred during the taxable or income year in connection with the rehabilitation of a qualified adaptive reuse building that meets the federal minimum income housing set-aside requirements or is listed in the California Register of Historical Resources.

This bill would make various changes to other provisions of the Government Code and the Revenue and Taxation Code. These changes do not impact the department's programs or procedures and, except to the extent they affect the tax credits authorized by this bill, are not discussed in this analysis.

SUMMARY OF AMENDMENT

The March 23, 2000, amendments deleted the language in the bill that would have required the Department of Housing and Community Development to make grants to property owners in downtown Los Angeles to reimburse the owners for rehabilitation expenses. The amendment added the provisions discussed in this analysis.

EFFECTIVE DATE

This bill would be effective January 1, 2001, and specifies that the tax credits would be operative for taxable or income years beginning on or after January 1, 2001.

Board Position:			Department Director	Date
____ S	____ NA	____ NP		
____ SA	____ O	____ NAR	Gerald H. Goldberg	4/18/00
____ N	____ OUA	X PENDING		

Legislative History

AB 601 (1999/2000), as amended July 13, 2000, would have provided the same provisions as this bill, however, these provisions were removed in the April 9, 2000 amendments. The bill at that point went to enrollment, but no longer impacted the department. The bill as enrolled was vetoed by the Governor.

SPECIFIC FINDINGS

Under the Government Code, existing state law provides for the designation of enterprise zones, Local Agency Military Base Recovery Areas (LAMBRA), a Targeted Tax Area (TTA), and two Manufacturing Enhancement Areas (MEAs). Using specified criteria, the TCA designates these economic development areas from the applications received from the local governing bodies. Enterprise zones are designated for 15 years (except enterprise zones meeting certain criteria may be extended to 20 years), and TCA has designated the 39 enterprise zones authorized under existing law. When an enterprise zone expires, TCA is authorized to redesignate that zone or designate another in its place to maintain a total of 39 enterprise zones. TCA is authorized to designate eight LAMBRAs. Currently, TCA has designated three of the eight LAMBRAs and two other areas have received conditional designation. Each LAMBRA designation is binding for eight years. The TTA was designated November 1, 1998, and the MEAs were designated October 1, 1998. Both the TTA and MEAs are binding for 15 years beginning January 1, 1998.

Under the Revenue and Taxation Code, existing state law provides special tax incentives for taxpayers conducting business activities within economic development areas. These incentives include a sales or use tax credit, hiring credit, business expense deduction, and special net operating loss treatment. Two additional incentives include a net interest deduction for businesses that make loans to businesses within the enterprise zones and a tax credit for employees working in an enterprise zone.

AB 1901, under the Government Code, would authorize a new type of economic development area, called an UARZ. TCA would be authorized to designate 10 UARZs from applications submitted by local governing bodies with “eligible areas.” The designations would be binding for ten years with the possibility of a five-year extension if specified vacancy rates exist at the end of the ten-year initial designation period.

From the submitted applications, TCA would be required to select for designation those areas that propose the most effective, innovative, and comprehensive regulatory, tax and program proposal, in addition to other incentives proposed in attracting private sector investment in the UARZ. In designating UARZs, the TCA must consider the location of other types of zones (including previously designated UARZs) and avoid locating new UARZs in a manner that would adversely affect any existing zones.

Local legislative bodies may by ordinance designate buildings located within the UARZs as “qualified adaptive reuse buildings.” In addition to being designated, buildings must have been built before 1975 and have been vacant for a period of six months or longer within 12 months of application for designation.

The ordinance must require the building owner to sign an adaptive reuse restriction agreement that requires the continued use of the property for adaptive reuse housing for a period of ten years. This adaptive reuse restriction agreement could be renewed at the option of the building owner for up to an additional 10 years, provided the adaptive reuse housing remains.

Qualified adaptive reuse would include (but is not limited to):

1. conversion of a nonresidential building to include at least 25% of the floor area as residential units or 50% of the floor area as live-work units, or
2. a 50% increase in residential or live-work use of floor area of an existing residential or live-work building. Theater space within a qualified building would be excluded from floor area requirements.

The terms “live-work” building and “live-work unit” are not defined in the bill or elsewhere in the Government Code.

Under the B&CTL and the PITL, this bill would conform with modifications to the federal rehabilitation credit and allow a tax credit in an amount equal to either of the following:

1. 20% of the amount paid or incurred during the taxable or income year in connection with the rehabilitation of a qualified adaptive reuse building, or

2. 30% of the amount paid or incurred during the taxable or income year in connection with the rehabilitation of a qualified adaptive reuse building that meets the minimum income housing set-aside requirements reflected in the Internal Revenue Code or is listed in the California Register of Historical Resources.

Under the PITL and B&CTL, “qualified adaptive reuse” would have the meaning provided in the Government Code, as discussed above. The PITL and B&CTL also would modify several definitions in the federal tax law rehabilitation credit provisions.

This bill would disallow the credit for any taxable or income year in which the taxpayer violates the “adaptive reuse restriction” agreement and would require the taxpayer to recapture any credit previously claimed.

Any excess credit would be allowed to be carried over indefinitely.

Since **this bill** does not specify, the general rules in state law regarding credits, including division of the credit among taxpayers who share in the costs, would apply.

Finally, this bill would require the department to report to the Legislature annually the number and amount of credits claimed and utilized.

Policy Considerations

This bill does not provide a sunset date and provides an unlimited carryover. However, if the bill were amended to provide a sunset date, consideration should be given to limiting the number of years the unused portion of any credit could be carried forward.

Credits with unlimited carryovers must be maintained on tax forms and systems long after the underlying credit has expired. Since tax credit carryovers are usually exhausted within eight years, most recently enacted credits contain limited carryover provisions.

Implementation Considerations

This bill raises the following implementation considerations:

This bill uses the phrase "minimum housing set aside requirements" as contained in Section 42(g) of the Internal Revenue Code. However, Internal Revenue Code Section 42(g) does not contain that phrase. The proposed amendment would change the phrase to "qualified low-income housing project requirements," as contained in Section 42(g)(1).

In addition, the proposed amendment would make stylistic changes to the PITL and B&CTL provisions to ensure consistency with other federal conformity language used throughout the PITL and B&CTL.

Upon discussion with author's staff, staff agreed to consider amendments to resolve the department's concerns.

TECHNICAL CONSIDERATIONS

The proposed amendment would rephrase the report requirement to clarify that both credits and credit carryover claimed should be included.

LEGISLATIVELY MANDATED REPORTS

The department would be required to annually report to the Legislature the number an amount of credits claimed and used under this bill.

FISCAL IMPACT

Departmental Costs

This bill would not significantly impact the department's costs.

Tax Revenue Estimate

Revenue losses under the PITL and the B&CTL are projected as follows:

Estimated Revenue Impact of **AB 1901** As Amended March 23, 2000 Beginning After 12/31/2000 (In $**Millions**)			
Fiscal Years	2000-01	2001-02	2002-03
Revenue Impact (rounded)	-$10	-$65	-$70

Approximately 20% of the impact above is attributed to the PITL.

Any possible changes in employment, personal income, or gross state product that might result from this bill are not taken into account.

Tax Revenue Discussion

Revenue losses would depend on the amount of expenses qualified for this credit and the state income tax liabilities of taxpayers in any given year. Revenue estimates were based on the federal rehabilitation credit (IRC Section 47), prorated to California and adjusted for the differences between the federal law and this bill.

BOARD POSITION

Pending.

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FRANCHISE TAX BOARD'S
PROPOSED AMENDMENTS TO AB 1901
As Amended March 23, 2000

AMENDMENT 1

On page 10, strikeout lines 38 through 40, strikeout pages 11 through 13, and insert:

17053.76. For each taxable year beginning on or after January 1, 2001, there shall be allowed as a credit against the "net tax," as defined in Section 17039, an amount determined in accordance with Section 47 of the Internal Revenue Code, modified as follows:

(a) Sections 47(a)(1) and 47(a)(2) of the Internal Revenue Code do not apply and in lieu thereof the following provisions shall apply:

(1) 20 percent of the amount paid or incurred during the taxable year for qualified rehabilitation expenditures with respect to a qualified adaptive reuse building (other than a building described in paragraph (2)), and

(2) 30 percent of the amount paid or incurred during the taxable year for qualified rehabilitation expenditures with respect to a qualified adaptive reuse building that is either of the following:

(A) a structure that meets the requirements for a "qualified low-income housing project" as described in Section 42(g)(1) of the Internal Revenue Code at all times during the applicable period of the adaptive reuse agreement described in subdivision (g), or

(B) a structure listed in the California Register of Historical Resources.

(b) For purposes of this section, Section 47(c)(1)(A) of the Internal Revenue Code shall be modified by substituting "qualified adaptive reuse building" for "qualified rehabilitated building." "Qualified adaptive reuse building" means any building if both of the following apply:

(1) The building has been substantially rehabilitated in connection with qualified adaptive reuse as described in Section 7093 of the Government Code.

(2) Depreciation (or amortization in lieu of depreciation) is allowable with respect to the building.

(c) The references to the year "1936" in Section 47(c)(1)(B) of the Internal Revenue Code are modified to refer to the year "1975."

(d) Section 47(c)(1)(C)(i)(I) of the Internal Revenue Code, relating to the definition of "substantially rehabilitated," is modified by substituting "50 percent of the adjusted basis of the qualified adaptive reuse building" for "the adjusted basis of such building".

(e) Section 47(c)(2)(C) of the Internal Revenue Code, relating to the definition of "certified rehabilitation," is modified to provide that "certified rehabilitation" means any rehabilitation of a qualified adaptive reuse building that is a certified historic structure that the State Historic Preservation Officer has certified as conforming with the Secretary of the Interior's Standards for Rehabilitation.

(f) Section 47(c)(3) of the Internal Revenue Code, relating to "certified historic structure defined," is modified to provide that “certified historic structure” means a structure listed in the California Register of Historical Resources.

(g)(1) In the case where any taxpayer who is a property owner has at any time during the applicable period violated the adaptive reuse restriction agreement required by local ordinance pursuant to Section 7093 of the Government Code, as found by the government official designated in that local ordinance, both of the following shall apply:

(A) No credit shall be allowed during the taxable year in which the violation occurs.

(B) The amount of the credit previously allowed, with respect to the qualified adaptive reuse building, shall be added to the taxpayer’s tax liability in the taxable year of the violation.

(2) The government official designated in the local ordinance required by Section 7093 of the Government Code shall notify the department of each violation of the adaptive reuse restriction agreement. The notification shall include each of the following:

(A) The taxpayer’s name.

(B) The taxpayer’s identification number, and each partner’s taxpayer identification number in the case of a partnership, for tax administration purposes.

(C) The date on which the violation was found to have occurred.

(3) For purposes of this subdivision:

(A) “Adaptive reuse restriction agreement” means an agreement described in subdivision (b) of Section 7093 of the Government Code.

(B) “Applicable term” means the term of the agreement described in subdivision (b) of Section 7093 of the Government Code.

(C) “Property owner” means the property owner identified in subdivision (b) of Section 7093 of the Government Code. (h) In the case where the credit allowed by this section exceeds the “net tax,” the excess may be carried over to reduce the “net tax” in the following year, and succeeding years if necessary, until the credit is exhausted.

(i) The Franchise Tax Board shall report annually to the Legislature the number and amount of credits and credit carryover claimed under this section.

SEC. 6. Section 23608.4 is added to the Revenue and Taxation Code, to read:

23608.4. For each income year beginning on or after January 1, 2001, there shall be allowed as a credit against the “tax,” as defined in Section 23036, an amount determined in accordance with Section 47 of the Internal Revenue Code, modified as follows:

(a) Sections 47(a)(1) and 47(a)(2) of the Internal Revenue Code do not apply and in lieu thereof the following provisions shall apply:

(1) 20 percent of the amount paid or incurred during the income year in connection with the rehabilitation of a qualified adaptive reuse building (other than a building described in paragraph (2)), and

(2) 30 percent of the amount paid or incurred during the income year in connection with the rehabilitation of a qualified adaptive reuse building that is either of the following:

(A) a structure that meets the “qualified low-income housing project” requirements as described in Section 42(g)(1) of the Internal Revenue Code, or

(B) a structure listed in the California Register of Historical Resources.

(b) For purposes of this section, Section 47(c)(1)(A) of the Internal Revenue Code shall be applied by substituting “qualified adaptive reuse building”

for “qualified rehabilitated building” except where otherwise provided. “Qualified adaptive reuse building” means a building described in Section 7093 of the Government Code.

(c) The references to the year “1936” in Section 47(c)(1)(B) of the Internal Revenue Code are modified to refer to the year “1975.”

(d) Section 47(c)(1)(C)(i)(I) of the Internal Revenue Code, relating to the definition of “substantially rehabilitated,” is modified to provide that the “qualified rehabilitation expenditures” must exceed 10 percent of the adjusted basis in the qualified adaptive reuse building.

(e) Section 47(c)(2)(C) of the Internal Revenue Code, relating to the definition of “certified rehabilitation,” is modified to mean any rehabilitation of a qualified adaptive reuse building that is a certified historic structure that the State Historic Preservation Officer has certified as conforming with the Secretary of the Interior’s Standards for Rehabilitation.

(f) Section 47(c)(3) of the Internal Revenue Code, relating to "certified historic structure defined," does not apply and in lieu thereof, a “certified historic structure” means a structure listed in the California Register of Historical Resources.

(g)(1) In the case where the taxpayer who is a property owner is found by the local government official designated in the local ordinance specified in Section 7093 of the Government Code to have violated the adaptive reuse restriction agreement at any time during the applicable term, both of the following shall apply:

(A) No credit shall be allowed during the taxable year in which the violation occurs.

(B) The amount of the credit previously claimed, with respect to the qualified adaptive reuse building, shall be added to the taxpayer’s tax liability in the taxable year of the violation.

(2) The local government designated in the local ordinance specified in Section 7093 of the Government Code shall notify the department of each adaptive reuse restriction violation. The notification shall include each of the following:

(A) The taxpayer’s name.

(B) The taxpayer’s identification number, and each partner’s taxpayer identification number in the case of a partnership, for tax administration purposes.

(C) The date on which the violation was found to have occurred.

(3) For purposes of this subdivision:

(A) “Adaptive reuse restriction agreement” means an agreement described in subdivision (b) of Section 7093 of the Government Code.

(B) “Applicable term” means the term of the agreement described in subdivision (b) of Section 7093 of the Government Code.

(C) “Property owner” means the property owner discussed in subdivision (b) of Section 7093 of the Government Code.

(h) In the case where the credit allowed by this section exceeds the “tax,” the excess may be carried over to reduce the “tax” in the following year, and succeeding years if necessary, until the credit is exhausted.

(i) The Franchise Tax Board shall report annually to the Legislature the number and amount of credits and credit carryover claimed under this section.